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# BUSINESS BUDGETING

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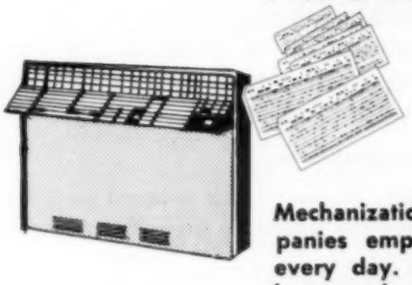
# AN ELECTRONIC MECHANIZATION APPROCH TO BUDGETING



*by M. R. Tyran*
*Collins Radio Company*
*(Formerly with Lockheed Missile and Space Division)*

**Mechanization of accounting has been progressing at a rapid pace recently. Companies employing electronic calculators are finding new uses for their new "brain" every day. The budgeting activities of most companies consume many valuable man-hours each year so it was inevitable that management would soon turn to the computer for help. This detailed case history of how one company successfully employed a computer in budget preparation should prove interesting to the overworked budget executive.**

**Introduction.**

A little over a year ago the Financial Management at Lockheed Missiles and Space Division (LMSD) decided to investigate the feasibility of employing an electronic computer for the preparation of the varied and many detailed elements of Management Budgets and Long Range Financial Forecasts. Management's purpose for this program initiation was to gain greater flexibility in budget/forecast production, reduce the preparation time span, monitor the accuracy of the reports through internal machine "checks" and controls and effect cost savings by diverting their "analytical" talent from the clerical computation aspect to report planning analyses and evaluation. The responsibility for development and implementation of this system was delegated to the Financial Forecasting Department because of their natural close association with all the minute details in the preparation of complete budgets/forecasts. We might mention at this point that the computer calculates and prepares the data for both the Management Budgets and Financial Forecasts. The budget is for a one year period and reflects greater detail than the forecast which generally covers a five year period at LMSD.

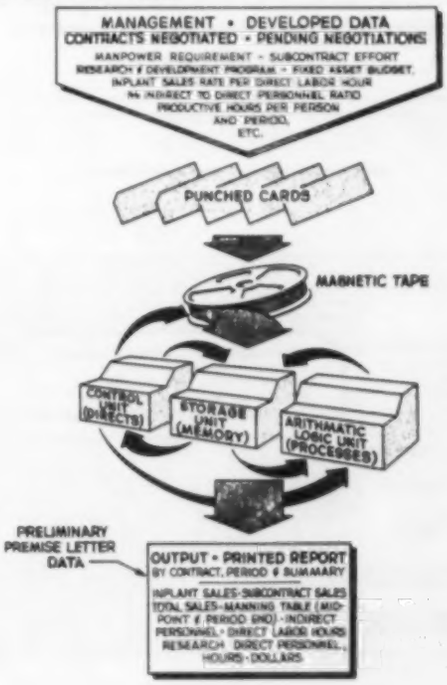
**Outline of the General Approach to the Program.**

As a preliminary step to initiating the mechanization program, a series of conferences were held between the Financial Forecasting Department and the Computer personnel to discuss and resolve specifically the following general requirements:

Definition of the program/problem (subject of this article)
Systems Development program
Output requirements
Input requirements
Data developments
Programming and Systems Test

Suffice it to say, the steps outlined above were resolved, developed and implemented in accordance with accepted standard practices.

In the following paragraphs, we will describe specifically, in the form of a discussion and illustrations, the specific inputs used, the machine computing operations and the resulting data obtained in terms of output. It is emphasized at this time that this system, in terms of data development, is discussed only with respect to CPFF contracts. No attempt will be made to analyze its possibilities with respect to commercial and/or fixed price business, although we do not doubt but that computer applications can also be used in these areas as well.



**Program Phasing.**

In order to clearly orient the reader as to the operation of the mechanization program, we have divided our subject into separate and specific phases. The employed segregations for purposes of this discussion are as follows:

Phase I — Preliminary Financial Forecast Premises' Development.
II — Detailed Cost Element and Sales Development.
III — Alternate Method of Cost and Sales Development.
IV — Statement of Income Development.
V — Reconcilation of Contract Fees to Net Income Before Taxes.
VI — Calculating Cost Holdbacks and Liquidation.
VII — Development of Cash Disbursements.
VIII — Development of Cash Receipts.
IX — Development of Cash Requirements.

## PHASE I — PRELIMINARY FINANCIAL FORECAST PREMISES' DEVELOPMENT

In this phase of operations, we developed specific and generalized information for Management review in order to resolve certain elements of data which are basic to detailed budget/financial forecast development. The data developed in this phase indicates to Management whether the preliminary projections are reasonable for the forecast development or is it necessary that the premises be modified before any further progress is made prior to detailed forecast development. As is noted in Exhibit I, the basic input information becomes available from the following sources:

Management.
Historically developed.
Manpower scheduling group.
Current contracts "in house" and/or anticipated results of proposals being or to be negotiated.

**Computer Input Requirements.**

The format of the "inputted" data is noted on Exhibit II. It includes the following input factors by period:

1. Direct midpoint headcount by contract and also indirect personnel performing direct functions.
2. Productive hours per direct person per day.
3. Number of work days per person per period.
4. Direct overtime as a % of productive hours.
5. Research and Development (R & D) % of total direct activity by contract.
6. Indirect headcount projection by activity.
7. Historically developed inplant sales rate.
8. Anticipated subcontract % of total effort by contract.
9. Overall projected annual General Research and Proposal dollar budget.
10. General Research and Proposal projected cost per Research direct hour.

It should be noted that there are three separate forms required to input this information, but the format for each is basically the same. The numbers entered at the top of Exhibit II are the time periods concerned. The first 24 minutes represent the first two years by month and the numbers 25 through 36 denote quarter periods for three years. This form can be used for a one through five year forecast.

**Machine Operation.**

The computer performs the following operations:

1. Converts direct midpoint headcount into direct labor hours by contract and summarizes the results (application of input items above — 1 x 2 x 3). Total direct labor hours times 100% + overtime % results in total direct labor hours to be expended.
2. Translates the developed direct labor hours into research and development and operations hour activity. This is done by application of item 5 above to the results obtained in computer Operation (1)

BASIC INPUT DATA FOR PRELIMINARY BUDGET PREMISES

Exhibit II

| FORECAST PERIODS | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 13 | 14 | 15 | 16 | 17 | 18 | 19 | 20 | 21 | 22 | 23 | 24 |
| | 25 | 26 | 27 | 28 | 29 | 30 | 31 | 32 | 33 | 34 | 35 | 36 |
| PROJECT IDENTIFICATION | | | | | | | | | | | | |
| PROJECT A | | | | | | | | | | | | |
| PROJECT B | | | | | | | | | | | | |
| PROJECT C | | | | | | | | | | | | |
| PROJECT D | | | | | | | | | | | | |
| PRODUCTIVE HOURS/PERSON/DAY | | | | | | | | | | | | |
| NO. WORKDAYS PER PERIOD | | | | | | | | | | | | |
| DIRECT OVERTIME % OF PRODUCTIVE HOURS | | | | | | | | | | | | |
| ANNUAL GENERAL RESEARCH & PROPOSAL PROJECTED BUDGET | | | | | | | | | | | | |
| PROJECTED GENERAL RESEARCH & PROPOSAL COSTS/DIRECT HOUR | | | | | | | | | | | | |

DIRECT MIDPOINT PERSONNEL BY PROJECT
INDIRECT PERSONNEL BY ACTIVITY
R & D % OF TOTAL DIRECT ACTIVITY
INPLANT SALES RATE BY CONTRACT
SUBCONTRACT % OF TOTAL CONTRACT EFFORT

above. The computer then converts the activity or straight time hours (excluding overtime) into a "special manning table" which is accomplished by dividing the direct hours obtained by factors of midpoint personnel conversion (items 1, 2, 3 above). The special manning table indicates midpoint personnel by classification (operations or manufacturing, research and development, etc.).

3. The computed midpoint direct personnel by type are next converted to period-end and combined with direct personnel which are derived on the basis of a projected indirect to direct % application. A complete manning table is "outputted" which includes project or contract direct personnel, direct research personnel, direct employees performing indirect functions, indirects, etc.
4. Direct labor hours (including overtime) by contract are extended by the projected inplant sales rate in order to obtain inplant sales dollars. The inplant sales rate is computer calculated based on historical data, anticipation and statistical techniques.
5. The reciprocal of the "inputted" subcontract % is applied to the inplant sales to obtain total sales. The projected subcontract % is developed on the same method basis as is noted in (4) above.
6. A machine schedule is printed and shows inplant, subcontract and total sales by contract and period.
7. The Management furnished General Research and Proposal dollar budgets are translated into Research direct labor hours which are spread on a machine computed percentage basis by period and converted into equivalent direct headcounts. The machine is also programmed to prepare a budget for General Research projects through the input and costing of direct midpoint Research personnel projections. Either procedure can be used and in most cases both methods are employed for a more thorough analysis of projected research and development activity.

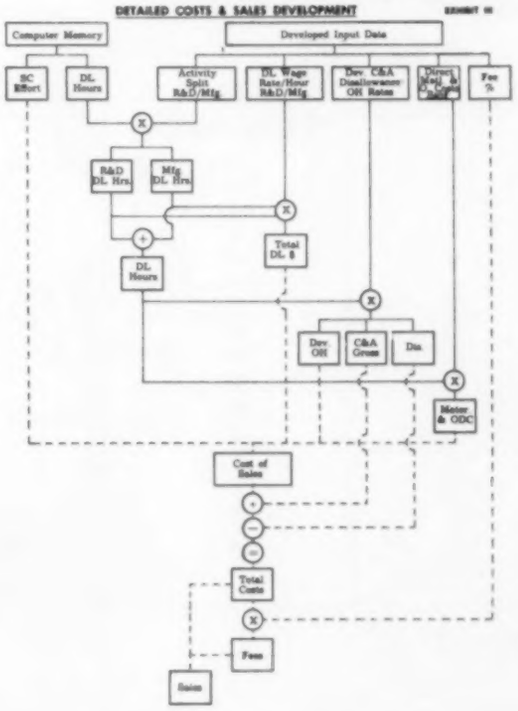
The above developed output information plus the projected fixed asset budget, disbursement and reimbursement lag factors, cash balance required premises, etc., is presented to Management who, in turn, add, delete, revise and/or approve the basic premises developed. With the "ground rules" established at least on a preliminary basis, activity commences toward developing supporting detail.

## PHASE II — DETAILED ELEMENT COSTS AND SALES DEVELOPMENT

Upon proper approval of the developed Phase I results, the basic data computed plus additional generated inputs serve to initiate the preparation of Phase II. This phase covers the machine computation by contract and period the following: direct hours, overhead, material and other direct costs, subcontract activity, etc.

**Computer Input Requirements.**

1. R & D and Manufactured labor rates per direct labor hour. These are computer calculated based on historical reference, negotiations, anticipated general and merit increases, etc.
2. Overhead rates segregated: Development, Contract and Administrative, and Statutory Disallowances.
   These rates are based on least squares technique and other statistical approaches. The overhead is projected by major overhead account, totaled and divided by direct labor hours to obtain the overhead rates.
3. Effective fee rates on subcontract and inplant costs by contract. The fee rates are based on adjusted current contract rates (conservative basis) and the anticipated results of fee negotiations.
4. Material and Other Direct Costs rate by contract direct labor hour. The terms of the contract indicate negotiated dollar values for material and other direct costs. This information plus historical reference and Operating and Contract personnel esti-



mates are fairly accurate barometers of projected costs for direct material and other direct costs. Other direct costs includes such items as travel, transportation, consultant fees, etc.

**Machine Operation.**

As is noted on Exhibit III, the computer performs the following operations:

1. Due to possible Management revisions in R & D effort of the total direct labor hours, the computer applies the % of R & D activity to the total direct hours to obtain the adjusted R & D direct hours and as a result of this computation, manufacturing direct hours are derived. Overtime hours are also re-calculated in instances where changes are made to the direct hours.
2. Applies the separate projected direct labor wage rates to the hours to obtain R & D and Manufacturing direct labor dollars. Straight time overtime wage dollars are included in the appropriate classifications of R & D and Manufacturing (or operating).
3. Applies the individual overhead rates to the direct labor hours to obtain the various type overhead expenses by classification (development, C & A and statutory disallowances). This is necessary in order to enter the appropriate overhead as a part of the cost of sales (development overhead) and the reductions thereto.
4. Applies the material and other direct cost rate to the direct labor hours.
5. Combines the following elements to obtain total inplant costs:
   a. Direct labor
   b. Development overhead.
   c. Material and other direct costs.
   d. Contract and Administrative expense.
   e. Statutory disallowances overhead.
6. The total inplant costs are divided by the subcontract reciprocal to obtain total costs. The difference between total and inplant costs is the subcontract cost effort.
7. Applies subcontract and inplant fee rates to their respective costs and this results in fee dollars which, when added to the costs, produces sales dollars.
8. The total cost of sales is obtained by combining the elements noted in item (5) above to the subcontract costs developed in (6) above.

As a result of the above operations, the computer then outputs the information contained on Exhibit IV, by time period, contract and total Divisional summary of the elements concerned.

## PHASE III — ALTERNATE METHOD OF COST AND SALES DEVELOPMENT

Under certain instances, Management as a group may decide on a specific sales level which it desires to project. In this case, we can use the material and other direct cost element as an adjusted (or forced) figure in order to produce a set sales level.

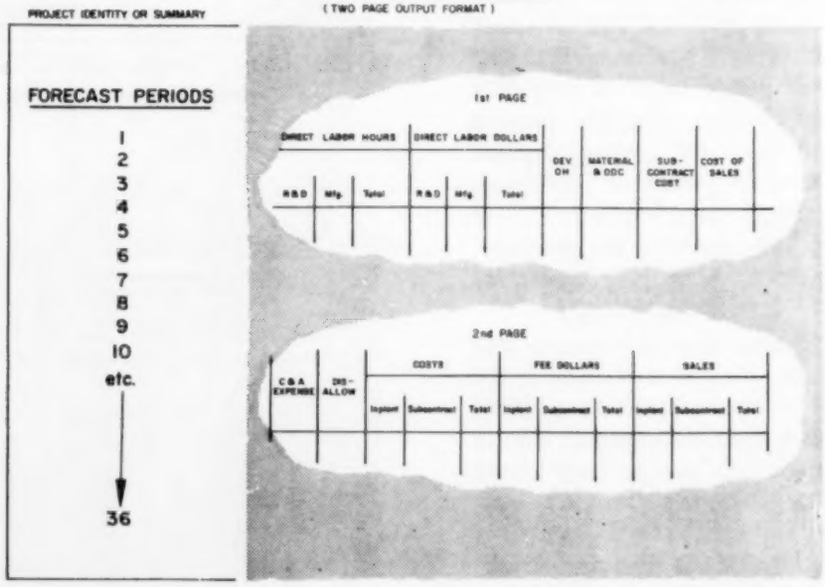
**Computer Input Requirements.**

Input data is the same as that used in Phase II with the exception that total sales are also in

DEVELOPMENT OF COSTS AND SALES DATA

EXHIBIT IV

(TWO PAGE OUTPUT FORMAT)



putted rather than material and other direct cost rates.

**Machine Operation.**

1. Items 1, 2 and 3 are once again applicable and as described under Phase II — Machine Operation.
2. The annual projected sales total is multiplied by the subcontract effort % to obtain subcontract sales. Those sales are deducted from the total sales to obtain inplant sales.
3. The inplant sales are divided by the total direct labor hours to obtain an inplant sales rate.
4. The direct labor hours by period are then multiplied by the inplant sales rate in order to distribute the inplant sales dollars by period (direct labor hours by contract and period are in computer memory). Due to contract differences, the sales rate is adjusted by judgment factors in order to reflect seperate rates by contract but their composite will equal the rate developed in (4) above.
5. The yearly subcontract sales totals obtained in (2) above is distributed by period on the basis of the number of weeks per accounting period. The subcontract and inplant sales are combined and machine adjusted to obtain the original sales dollar premised under Phase III above.
6. Subcontract sales are divided by 100% plus the subcontract fee rate to obtain subcontract costs. The subcontract fee rate is based on negotiations and anticipations.
7. Inplant sales are also divided by 100% plus inplant fee rate to obtain inplant costs.
8. In order to obtain the material and other direct cost element, the following procedure is used by the machine:
   a. Total Inplant Costs (Item 7 above) less C & A Expense plus Disallowances equals total cost of sales.
   b. Total Cost of Sales less subcontractor costs, direct labor dollars, development overhead equals the material and other direct cost element.
9. The developed material and other direct costs are next divided by the total direct labor hours to test the reasonableness of the computer developed rate. If it does not appear to be reasonable; that is, based on historical reference, negotiated contracts and future anticipations, an adjustment is made and the program reverts to Phase II computation.

The same output as recorded on Exhibit IV is prepared as a result of Phase III. The Phase III method lends even greater flexibility to machine computed projections. In other words, more than one method can be employed to make budget projections and develop the detailed cost element requirements.

## PHASE IV — STATEMENT OF INCOME DEVELOPMENT

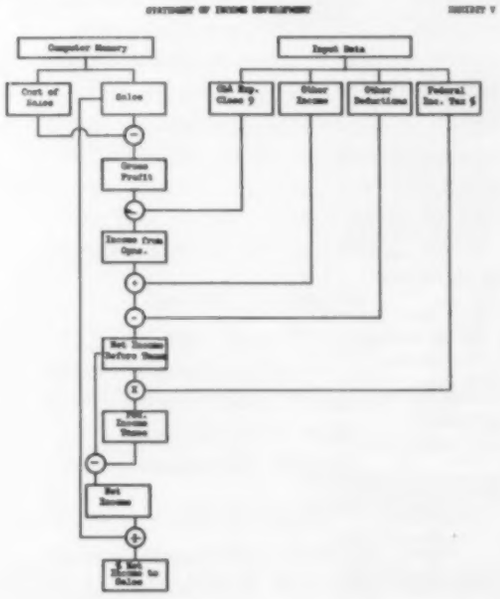
As soon as the computer has concluded the development of the cost buildup and sales, then it proceeds to the next step of preparing the Statement of Income. Data already computed plus additional inputs are required in order to accomplish the preparation of this statement.

**Computer Input Requirements.**

The following input data are required: C & A Expense Dollars, Other Income (discounts earned), Other Deductions (such as basic and general research, project abandonments, interest expense, etc.), and Federal Income Tax Rate (52%). This data is statistically developed based on historical experience. Management provides guidance as to the reasonableness of the information used.

**Machine Operation.**

Since this operation is similar to common acconting precedure, it requires no further comment as the computer prepares the schedule along the lines of manual preparation. A flow chart of the computational steps involved however is noted on Exhibit V. The output of the data is



in standard accounting format and additionally the machine calculates and outputs the percent relationship of each element to the total sales. The output is by period and contract. The type and format of consolidations are dependent upon the organization's requirements.

## PHASE V — RECONCILIATION OF FEES TO NET INCOME BEFORE TAXES

This control step is necessary in order to test the validity of the fees developed on our cost and sales schedule (Phase II or III) as compared to the net income before taxes developed on the Statement of Income. Statutory disallowances are the only input required.

**Machine Operation.**

1. The computer will consolidate the various contract developed fees as derived in Phase II or III. It is noted that this checkout can be made by individual contracts if the organization concerned so desires. The programming has been tailored to accomplish either method.
2. The computer will reduce the fee total derived in (1) above by the other deductions net contained in the Statement of Income, and the "inputted" statutory disallowances.
3. The result obtained from (1) and (2) above will then be compared to the Net Income before Taxes on the Statement of Income. The variance should not exceed $5,000 which can generally be attributed to the resultant "rounding" involved in fee calculations. If the variance is greater, further program development stops and an analysis is made to determine the cause for the difference. The $5,000 variance is considered reasonable since it represents only a .2% difference when compared to the magnitude of the number concerned.

The output format of data requirements is noted on Exhibit VI.

**ANALYSIS OF DISALLOWANCES AND NET INCOME BEFORE TAXES** — EXHIBIT VI

| | Annual Forecasted Periods |
|---|---|
| **Fees From Sales Development** | |
| Project A | |
| Project B | |
| Project C | |
| Total Fees | |
| **Less: Normal Disallowances** | |
| Excess Amortization | |
| Advertising & Sales Promotion | |
| Entertainment | |
| Dues & Donations | |
| Business Interruption Insurance | |
| Corporate Management Allocation | |
| Other Negotiated Disallowances | |
| Total Normal Disallowances | |
| **Less: Other Disallowances** | |
| Interest | |
| Land Gift | |
| Deferred Development | |
| Other | |
| Total Other Disallowances | |
| Total Disallowances | |
| **Total D/L Hours** | |
| **Total C&A Hours** | |
| **Disallowance Rates** | |
| Normal | |
| Other (Statement of Income) | |
| Total | |
| **Reconciliation of Net Income Before Taxes** | |
| Fees from Sales Development | |
| Less: Disallowances, Rate Variance & Fee Loss (Above) | |
| Net Income Before Taxes — (Sales Dev.) | |
| Net Income Before Taxes — (Statement of Income) | |

## PHASE VI — CONTRACT COST HOLDBACKS AND LIQUIDATION

Since some Government contracts contain cost holdback clauses before and after contract definitization, a means was devised for the computer to calculate this data and then to follow through on the liquidation aspect of the generated holdback in order to obtain the effect on cash operations and receivable/payable balances. Input data required is as follows:

**Computer Input Requirements.**

Total Cost and Subcontract Cost Holdback percents by contract and period (based on negotiations and/or anticipations). Liquidation factors which are manually or computer developed and based on projections of item deliveries, vehicle flights, program phase completions via direct labor usage, etc. It is noted that the factors are developed for both the total contract (in-plant plus subcontract) as well as for the separate subcontract effort.

**Machine Operation.**

1. The computer will select the applicable contract and accumulate the total contract as well as the subcontract costs by period commencing with date of holdback initiation.
2. The holdback percent is then applied to the cumulative total and subcontract costs to obtain the cost holdbacks by period.
3. The computer next applies the liquidation percent factors to the cumulative holdback costs as developed in Item 2 above to obtain liquidation dollar amounts.
4. The liquidation dollars are deducted from the cumulative holdback costs to obtain cumulative net cost holdbacks.
5. The cumulative net holdback is then translated into incremental cost holdback by period.
6. The same procedure is followed for developing the subcontract cost holdback and liquidation dollars.

**DEVELOPMENT OF CASH DISBURSEMENTS** EXHIBIT VII

(INPUT FORMAT)

| FORECAST PERIODS | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 |
| | 13 | 14 | 15 | 16 | 17 | 18 | 19 | 20 | 21 | 22 | 23 | 24 |
| | 25 | 26 | 27 | 28 | 29 | 30 | 31 | 32 | 33 | 34 | 35 | 36 |
| ITEM DESCRIPTION | | | | | | | | | | | | |

**MAJOR DISBURSEMENT CATEGORIES TO BE DEVELOPED**
(WITH SPECIAL INPUT DATA)

A. ACCOUNTS PAYABLE
(Reduction to O/H)
Indirect Labor
MIP
Depreciation
Retirement
Mgmt. Allocation
Discounts
Property & Other Taxes
Employers' Taxes
Construction Advances
Govt. Facilities
Fixed Asset Purchases
Non-Prod. Inventory

B. GROSS PAYROLL
Vac./Hol. Accrual/Payment Factors
Employers Withheld Accrual Payment Factors

C. PROPERTY & OTHER TAXES
State Franchise Tax
Sales & Use Tax
Real & Personal Property Tax
Other Taxes

D. DIVIDENDS

E. FEDERAL INCOME TAX
Real & Personal Prop. Tax Factors

F. ITEM LAG PERIODS BETWEEN ACCRUAL & DISBURSEMENT

7. The total incremental holdback costs by period are added to or subtracted from the cash receipts in order to reflect their effect on cash operations.

The computer prints out a schedule which indicates by contract the following information by period:

Incremental costs.
Total cumulative costs.
Holdback percent.
Liquidating factor.
Liquidation dollars.
Net holdback.
Incremental holdback costs.

The same data as noted above is also generated for subcontract cost holdbacks.

## PHASE VII — DEVELOPMENT OF CASH DISBURSEMENTS

In addition to the development of Costs and Sales plus related data, LMSD has also programmed a procedure for machine computation of Cash Receipts, Disbursements and the resultant schedule of Cash Requirements. For purposes of sequencing, we have elected to discuss cash disbursements first which we will follow with receipts and then cash requirements. It is noted that although the overall cash projection procedure is quite involved and detailed, it is necessary and important in order to achieve as accurate a forecast in the cash area as is possible to obtain. Needless to say, cash requirements financing is an important matter in any business organization, therefore, great care is exercised in projecting cash receipts and disbursements.

The required cash disbursement data is noted on Exhibit VII. Much of the informational requirements have been computer developed and are in machine memory. It is now necessary that the machine manipulate the items concerned to produce the required output.

**Machine Operation.**

a. *Accounts Payable Disbursements.* The total overhead dollars must be reduced by certain expense accounts (note Exhibit VII) which are either included with other output disbursement categories (indirect labor, for example, with gross payroll) or not applicable as a non-cash item such as depreciation. Added to this computed balance is then the following other pertinent and specific disbursements in the accounts payable classification:

**Machine Computed**

Inplant Material Costs
Subcontract Costs
Inter-division Purchased Sales
Fixed Price Material
Commercial Material

**Direct Inputs**

Construction Advances
Government Furnished Facilities

Fixed Asset Purchases
Non-Productive Inventory Purchases
Corporate Allocation and Interest
Appropriate Lag Periods for
Machine Computed Data

It is noted that the machine computed data is appropriately lagged in order to represent cash payments. The lag periods or time elapse between cost incurrence and cash payment are predicted on historical reference and judgment as to anticipations (the average runs about 40 days). The manual direct inputs are lagged prior to incorporation into the machine program. The total value of the above data now represents — Accounts Payable Disbursements. The difference between the cost and payment represents a part of the over-all accounts payable balance on the Statement of Financial Position.

b. *Gross Payroll Disbursements.* The computer combines all of the labor dollars and adjusts these dollars for the influence of the following elements with respect to accruals and payments: (1) Vacations and holidays, (2) Employees withholds (FICA, SDI, etc.) The developed data is properly lagged to represent gross payroll disbursements. Generally speaking, gross payroll is lagged one week. This means that 75% of the total gross payroll generated in one month is paid in that month.

c. *Dividend Payments.* Lagged direct input (paid quarterly but accrued monthly).

d. *Property and Other Taxes.* Primarily direct inputs are manually developed because of the various lag periods involved in each of the element payments. This disbursement category covers State Franchise Taxes, Sales and Use Taxes, Real and Personal Property Taxes, etc. Due to report requirements, each of the above items is developed and shown separately.

e. *Employee Retirement.* This is currently a lagged direct input and is paid quarterly but is accrued monthly.

f. *Federal Income Taxes.* This disbursement is derived from the machine developed Statement of Income and lagged for payment one month after liability is generated.

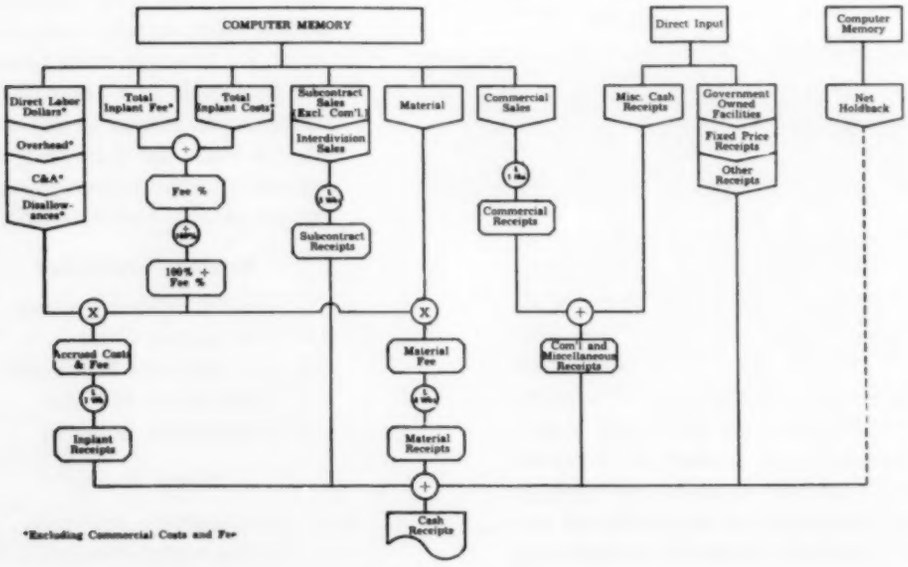
The total of the above categories represents the over-all Divisional disbursements. It is noted that the selected and developed expense categories will vary among organizations due to the different organizational requirements involved.

## PHASE VIII — DEVELOPMENT OF CASH RECEIPTS

Actual cash receipt development is based primarily on cash disbursement data when one speaks of CPFF contracts. Fixed price receipts are handled somewhat differently. The primary differences between receipts and disbursements are attributed to the following general factors:

DEVELOPMENT OF CASH RECEIPTS

EXHIBIT VIII




*Excluding Commercial Costs and Fee

Lag period variances by element between disbursement and reimbursement.

Inclusion of fee dollars in receipts.

Elimination of disbursement items with no receipts involved as, for example, fixed asset purchases.

All of the cash receipt inputs required for receipt development have either been machine "inputted" specifically for generating cash disbursements.

**Machine Operation.**

The primary machine operations involved are the manipulation of the elements to produce the required receipt category combinations, calculation of fee dollars and the application of lag factors. The detail of this information and its manipulation is shown on Exhibit VIII. Here again, the specific outputs are dependent upon organizational requirements. Basically, the items contained in this Exhibit are common to all CPFF organizations, but no doubt the combinations for the printed output schedules may vary.

## PHASE IX — DEVELOPMENT OF CASH REQUIREMENTS

As soon as the machine has developed cash receipts and disbursements by contract, period and Divisional summary, the next step is to develop cash requirements. All of the items required for input are in the computer with the exception of the beginning cash balance.

**Machine Operation.**

The computer totals and calculates the difference between cash receipts and disbursements. The result is noted as a net increase or decrease in cash. The machine next algebraically adds the beginning cash balance to the net increase or decrease in cash and determines whether this total is sufficient to meet the predetermined and projected cash operating requirements. It is noted that the computer has been programmed to maintain a required operating cash level (which is dependent on organization needs.) As a result of the computation above, cash needs and surplus is calculated. For purposes of borrowing or loan repayments, specified dollar increments such as $200,000, $400,000, etc. are used by the computer in establishing the amount to be borrowed or repaid. The resultant differences between cash availability and requirements is the cash balance. The output schedule includes itemized receipts and disbursements, net increase or decrease in cash as a result of the period's activity, beginning cash balances, cash requirements or availability and ending cash balances.

**Summation.**

Throughout this article, we have tried to relate the steps employed in our approach to the implementotion of a computer system for preparing budgets/forecasts applicable to a CPFF business. With little change, this system could be adapted for other organizations which have the same general business characteristics. Although this system is currently operable at LMSD, we do not feel that its stage of development is anywhere near our projected goals. We are now exploring the following related areas in order to achieve the ultimate requirement of producing additional data which will assist Management in their decision-making and control processes:

Computer prepared working trial balance in order to achieve Division's Statement of Financial Position for Management consideration.

Computer developed space requirements and fixed asset budget data as a "tie-in" to manpower projections so that Management can more readily evaluate the impact of one element on the other.

Computer prepared premises for contract negotiations in which various alternative schedules will be produced for Management's decision as to the final bid submittal.

Incorporation of actuals into the computer so that they can be compared to the projections, variances calculated and identified to specific contract elements. Also, many of the input parameters can be developed directly from this data.

As a result of the above described computer application technique, the following advantages are predominant in LMSD's current praparation of Management Budgets and Financial Forecasts:

Data development and revision flaxibility.

Reduction of report preparation time span.

Production of more detailed data for report evaluation.

Diversion of analytical talent from routine computational detail to planning and analysis functions.

Establishment of internal computer control checks for monitoring the development of projections.

Absolute computational accuracy.

Based on the number and varied forecasts required during year, it is estimated that forecast mechanization saves LMSD 4,300 manhours or $20,000 per year.

# WRITING FOR THE BUSINESS PRESS*

*Pilson W. Kelly*
*Ford Instrument Company*
*Division of Sperry-Rand Corporation*

**Business men cannot escape the need to put their thoughts and ideas on paper for the benefit of others. The manager that can do the best job of presenting his ideas is more likely to receive favorable notice from top management. Budget officers particularly find it necessary to communicate both up and down the line. Mr. Kelly, himself a successful author, has succeeded in writing a most helpful article on written communications. (Note: The Editor is hopeful that this article will precipitate a flood of articles for publication in BUSINESS BUDGETING)**

In our rapidly changing times, many aspects of business and management need to be described, explained, or discussed — and it often happens that the managers who know most about a subject never put a word about it on paper. There are probably several reasons for this — lack of time, lack of inclination, lack of opportunity for publication — but the main reason is probably nothing more than the manager's feeling that "I'm not a writer."

To a greater or less extent, this may be true, the ability to write for business and management publications is one that most executives can develop, once they have a few basic guideposts.

The art of writing consists of simple methods for making things easy and benefical for the reader, rather than for the writer. In the same way that a profession has been defined as a conspiracy against the layman for his own good, writing is a conspiracy against the reader for his own benefit. The reader's interest must be captured quickly and held against many distractions — often even against his life-long views and prejudices — in order to give him the benefit of ideas or information he should have.

## ELEMENTS OF WRITING

The Polynesian neighbors of Robert Louis Stevenson came close to the essential nature of a writer when they called him "Tusitala" — Teller of Tales. If we go back to the first great western epics, Homer's *Iliad* and *Odyssey,* we find that the stories antedate the writing, for they were told by word of mouth for centuries before writing became common. The story came first, and after that the writing. It remains so today: the story is the important element.

A good "story" on any subject usually has pretty much the same characteristics as a good painting: It has a center or centers of interest, with enough panorama to show them clearly and distinctly in relation to the background. The result is believable, because it is geared to reality in the sense of man's common experience.

Most good paintings have interest, clarity, distinctness, and organization, but the industrial article must also have usefulness to readers, giving them practical suggestions for improving their work, or at least an increased understanding of it. In the best articles, the reader finishes with something that he didn't have when he started.

### Selecting a Subject

Most of us have heard of the old recipe for rabbit stew that began with the words, "First, you catch a rabbit." The first step in writing for publication is similar: first, have something to write about.

In addition to its usefulness to industry, it is extremely helpful if your subject can measure up to three other criteria: (1) it's a subject you understand; (2) it's a subject you know from more than one viewpoint; and (3) it's a subject in which you have a lively interest.



*Reprint from the February 1960 Issue of "Management Review"

It's always best to write about something you understand, and understand over a fairly wide range — preferably something from your own experience, rather than dug out of a library. The stereoscopic effect that results from the proper combination of data taken from two slightly different points of view can do as much for an article as it does for a three-dimensional picture. Most of us know some subjects from two viewpoints: supervisor and workman, shop and office, sales and service, government and industry, tax and financial, military and industrial, and so on. The reader receives the benefit of this additional perspective without being required to bring it to his reading.

One can usually do the best job with subjects that have his interest and enthusiasm. Man's heart is where his treasure is, and he can usually get the most out of situations he has put something into. A prolific writer does not necessarily love many things, for it is possible to pick one broad theme and write on various aspects of it for a lifetime, as Dickens did on needed social reform, and as Michael Pupin did on electrical resonance.

Thus, one way to select the subject of an article is to list the ones you understand with stereoscopic vision, cross out those you have little interest in, and pick the most useful to industry at the time.

#### Telling the Story

There are prerequisites to most accomplishments. When one sets out to acquire a professional license or a Ph.D. degree, he usually starts when he is young, so he will have it when he is old. Similarly, it is unreasonable to expect to become a competent story-teller without some practice — which, happily, is easily obtained.

One way to obtain such practice is to tell bedtime stories to children between three and five years old. This is an application of an ancient and effective principle: start toward the beginning of things, if possible, where they first come out of the ground. If you pride yourself on your capacity for exposition, you may be in for a shock.

Start with *The Three Pigs.* If you get your pigs mixed, or if the first pig's hut was made of straw last night and of sticks tonight, you'll hear about it. Then, with Daniel in the Lion's Den, what is a den, and how did Daniel get into it in the first place? When a half-dozen stories go over without contradiction or question, rest assured that your exposition is clear and reasonable. (Be sure to pick up a copy of *Aesop's Fables,* because you're going to have to keep this up — by audience request.)

Another way of obtaining practice in exposition is to talk to the high school boys in your neighborhood. If you can't help with their school subjects, almost anything done for a living is interesting to them — automobile repair, traffic management, personnel work, and the like.

Still another approach is to listen to your associates telling anecdotes and stories. Some of these raconteurs are better than others. Notice the differences; recast some of the tales and see whether you can tell them at conversational speed in less than 30 seconds. Write them, condensing still further, without terseness. One way to become a Tusitala, a teller of tales, is to get into the habit of telling one occasionally.

In pursuing the story, let us be careful about what we undertake to explain, for we have it on the word of Voltaire that anything really requiring explanation cannot possibly be explained.

#### Clarity and Distinctness

What seems to be the best description of clarity and distinctness comes from Leibnitz, a mathematician and logician of several hundreds years ago. According to him, an entity is clear when it can be defined precisely; otherwise it is obscure. The clear thing is distinct when the parts, and the parts of the parts, and their mutual relations can be defined; otherwise it is confused. The ability to define and relate the parts, and the parts of the parts, is indispensable to the accurate writer.

#### Sources of Error

The writer can do two things to help himself to avoid errors in his writing. He can refer occasionally to a standard list of fallacies, or errors in reasoning; and to familiarize himself with the fountain springs of error, he can review the idols of Francis Bacon: The Idols of the Cave, concerning the aberrations of the individual man, such as predisposition to antiquity or to novelty; the Idols of the Tribe, which cause us to follow past thinkers blindly into changed conditions and ignore proof to the contrary; the Idols of the Marketplace, which cause us to twist language to seek our own advantage; and the Idols of the Theatre, which cause us to set ourselves up in a dream world which has no existence whatever in fact. Few troublesome problems of industry cannot be traced back directly to one or more of the Idols.

### Editors and Writers

The editor constitutes a reserve battalion in support of the writer. The editor knows the requirements of his readers, their likes and dislikes, and he is both willing and able to make many subtle improvements in the script.

It's well to remember that the editor is on your side. His purposes are the same as yours: to bring the clearest, most cogent, and most helpful ideas to the attention of his readers. An editor will never turn down a really useful article because it lacks professional style; give him a clear, well-reasoned exposition with real substance and he'll be glad to spend some time smoothing over the rough spots.

## TECHNIQUES OF WRITING

An excutive writing for publication can't possibly spend the amount of time that a professional writer would devote to his task. That's why he must make use of the quickest, most effective techniques he can find to help him to tell his story with a maximum of efficiency and a minimum of waste motion.

### Research

A common question to a writer by avocation is "When do you ever find time for your research?" Research is a much-abused term in writing. Independent, original work is one of the most useful subjects of industrial writing, but there is not much of it, and the term *research* is commonly extended to mean looking up what others have written. This has many deficiencies.

In the first place, it is a laborious process, and sometimes, despite the best efforts of librarians, one can find everything except what he needs. More importantly, the reason most industrial problems are problems is that there hasn't been much effective writing concerning them. By the time there is much in print on a subject, industrial interest often has passed to other things. Besides, there is the evil of successive diminution: an expert writes part of what he knows, the writer absorbs it without the expert's background, losing something in the process, then translates it, losing some more. The reader would do better to refer to the expert in the first place. In addition, the work can get far from reality as the writer starts to sound like the couplet from Kipling: "O this I heard, and that I read, and this was noised abroad,/ And that I got from a Belgian book, on the word of a dead French Lord."

When an executive is well-versed in his subjects, he can practically dispense with research, except to verify facts. The best position of the manager-writer seems to be: "All of this I saw — and part of it I was."

### Approach and Outline

Approaching a subject is best done in the same way that a mountain climber examines a mountain. He looks it over carefully from many viewpoints, noting the various aspects, differentiating between the promising and the less attractive, and selecting the best approach.

It's helpful to make a detailed outline of the article before any writing is done. One way to arrive at the order of presentation is to note the various possibilities and select the one which most naturally fits the subject. Once the chief elements of the subject are identified, the natural method usually presents itself.

Ordinarily, the writer can set forth his points chronologically, in order of increasing or decreasing importance, or by separating the pros and cons. The basic sections of the subject may naturally constitute an order of presentation.

Although a clear, detailed outline is essential from the beginning, many writers soon learn to work from a mental outline, just as a battle commander may do at any moment what he guesses ought to be done, from his knowledge of the situation and his mental outline—and then write the master plan and grand strategy after the war.

### The Medium of Expression

After the planning has been done and the framework has been tentatively decided, the fact remains that the presentation is going to have to be made in words, and some kinds of words are better than others for exposition or explaining. The general rule of never using a complicated or obscure word when a simple one will do the job still holds true. In English, the Anglo-Saxon and the related Danish, Norse, and Middle English words have the most precise, unmistakable, universally understood meanings. Words of Latin origin, which compose most of the remainder of English, are much less precise and much more easily misunderstood. For example, *beat* or *hit* is more precise than *assault* or *attack;* and *house* or *dwelling* gives a clearer understanding than *structure* or *edifice*. Of course, when we need a word of broad range, we will usually require a word of Latin derivation. But to explain things clearly and unmistakably, it helps a writer to favor the northern words, which

can be recognized by their short, one-piece, clear nature.

Another effective technique of exposition is the topic-sentence type of paragraph construction, in which the first sentence contains the gist of the paragraph and the remainder describes it more completely.

#### Argument and Controversy

Generally speaking, argument and controversy should be avoided, but many interesting subjects of importance to industry naturally require them. One way to make a contribution without offense is to present both sides and let the reader take his choice.

A considerable increase in effectiveness was brought to this method some centuries ago by Thomas Aquinas. He not only presented the opposition's position fairly and fully, but proceeded to strengthen and reinforce it better than its adherents could. When he had built the opposing position up to where it seemed impregnable, he would quickly knock it apart completely. For important matters, this method is sometimes useful.

#### Balance

It is important to avoid seeming dogmatic or too authoritative, and an easy way to remember this is to recall the praying habits of the ancient Greeks. They assembled small statues of their gods, each on his own little altar; but there was always an extra altar — for the god who might exist without their knowing it yet.

However, balance and safety should not be bought at the price of so many pulled punches, reservations, and exceptions that little useful material is left. It is helpful in arriving at balance to reflect that it is much easier for an editor to tone down an article than it is to breathe life and power into one that has been diluted by timidity.

#### Mechanical Procedure

Consultation with writers indicates that there is no substantial agreement on the best method of putting an article on paper in typed form for submission. Some prefer to dictate to a stenographer or to a machine; others use a typewriter exclusively; others write their first draft in longhand. The choice seems to be personal, and each method has its adherents.

There is considerable agreement, however, on these points:

1. The handwriters often habitually write in ink, since the difficulty of erasure operates as a coercion on mind and hand to write precisely and deliberately.

2. There is some evidence that writers with the fewest facilities operate at the best speed. For example, the lack of extensive typing assistance results in writing substantially in finished form the first time — a virtue caused by necessity.

3. There is strong evidence that the best way to ruin the work is by too many drafts. Dictate the article roughly; bluepencil the draft into another draft, redpencil that, greenpencil the result in to the finished product—and the whole job may be refined to death.

#### Finishing the Article

It seems to be part of the nature of fine artists in any line to be their own severest critics, with an urge to make their work better. Perhaps this is one of the things that make them good artists. Recently, the guards at a museum were within an ace of arresting an old gentleman they discovered merrily painting over the corner of a treasured canvas, until they found that he was indeed the original artist.

However, even good things tend to suffer from an excess of themselves, and often what is needed most is someone to take the work away from its creator before he ruins it with "finishing touches." Don't spoil things by working them over too much. If your articles are not satisfactory, try leaving off the finishing touches and see what happens.

## SUMMARIES, EXHORTATIONS, AND CONCLUSIONS

Finishing an article resembles tiger-riding, in that one must be careful how he dismounts. It is a custom of the trade for the article to have a conclusion, in about the same way that a song ends with a chorus. One way of doing this is a concise summary; if the theme is widely spread, this is the last chance to unify it. It often helps to end on a note of encouragement to the reader, such as reference to ways to better things. On special occasions, such as writing in defense of a lost cause, one can go down with the turrets blazing, and, at happier times, end with the clang of cymbals.

Writing is an uncertain activity, but two things were promised to the writer by the poet Aeschylus, several thousand years ago:

1. He who sings to the gods a song of hope will find his prayer noticed.

2. He who smites the lyre with a chunk of his soul will never lack an audience.

# THE PRESIDENT'S MES

*With this issue of Business Budgeting we are initiating a new section, tentatively titled "The President's Message." The purpose is to keep you informed of activities on the National level. Future issues will include reports from the Government Budget, Text Book and Education Committees. Other items of interest will be reported from time to time. In this issue we will cover two items: (1) a job description for Regional Directors; and, (2) a report of the Awards Committee by Chairman, Larry Haverkamp.*

Arthur D Moor
*President*

## FUNCTION AND RESPONSIBILITIES OF REGIONAL DIRECTOR

On July 1, 1960, two elected Regional Directors from each of the six newly created regions began serving as members of the Board of Directors of the Society. The first step in the new Regional plan of organization had been taken.

To insure the effective operation of the new organization, the function and responsibilities of the Regional Director's job had to be clearly defined and understood. In July, the Regional Directors met in Chicago with the other Officers of the Society to develop the needed job description. At this meeting, the general scope and nature of the job was agreed upon.

A preliminary draft of the Director's function and responsibilities was reviewed at the Board of Directors' meeting on October 22nd. After a thorough discussion the following job description was unanimously approved:

> The Regional Director is a member of the Board of Directors.
>
> As a member of the Board, he is to use his experience and judgment in an objective manner for the good of the society as a whole.
>
> He represents the chapter members of his region in the deliberations of the Board of Directors and in matters referred to the President.
>
> He clarifies and explains the opinion and decisions of the Board to chapter membership.
>
> He has no administrative responsibility or authority.
>
> He offers help to chapters in his region who need assistance in chapter administration and operations.
>
> He encourages chapter development and growth and encourages chapter participation in national policies and programs.

## REPORT OF THE AWARDS COMMITTEE

At the Annual Conference in Cincinnati last May, awards were presented for the best article in Business Budgeting, the best chapter brochure and the best Chapter Newsletter. Because the awards program has been so well received it seemed desirable to continue it during the current year. Larry Haverkamp was asked to serve as Chairman of the Awards Committee this year and to develop a plan to present to the Board of Directors. Larry's report was presented and approved by the Board on October 22nd. Since every member is a potential candidate for the Business Budgeting award and every chapter will be competing for the other two awards, the highlights of Larry's report are presented here for your information:

Plans for the continuation of the three National awards presented last year were approved by the Board of Directors in their meeting at Chicago on October 22, 1960.

The three National Awards to be presented at the National Conference in May, 1961 at Dallas will be:

1. Best Article in Business Budgeting
2. Best Chapter Brochure
3. Best Chapter Newsletter

A brief description of the awards and committee members follows:

1) Best Article in Business Budgeting.

An award consisting of a suitable plaque plus a $25.00 check will be presented to the person whose article, published in Business Budgeting in the calendar year 1960, is considered the best. The committee, with National President Art Moor's concurrence, has decided to exclude from consideration the published talks delivered at the Annual National Convention.

Through this award we hope to encourage the writing of articles for Business Budgeting. There is a two-fold purpose here: one, to insure an adequate editorial selection of articles for publication; and two, to attempt to uncover new authors with new material.

The 1960-61 Committee selected for the important task of determining the best article is

Emil Lage — San Francisco Chapter
Lew Landreth — Chicago Chapter
Larry Haverkamp — Cincinnati Chapter

# MESSAGE . . .

2) Best Chapter Brochure.
One of the most productive pieces of material to put into the hands of the membership chairman is an attractive brochure. The messages, member information and program information it contains are vital to a well-rounded membership campaign.
To encourage every chapter to put its best-foot-forward, an award will be given to the chapter publishing the best brochure for the chapter year 1960-61.
The 1960-61 Committee selected for judging the best brochure is:
Carl Bacon — St. Louis Chapter
Al Schaake — Boston Chapter
Larry Haverkamp — Cincinnati Chapter

3) Best Chapter Newsletter.
Chapter newsletters serve to keep the local members fully informed as to the important happenings on a local level. Some of the chapters also make use of the newsletters to present a summary of the chapter meeting talks or discussions for particular services to the members who were unable to attend.
A chapter needs the intimacy afforded by a newsletter as it welds the chapter's purpose and direction. We hope to encourage one man in each chapter (though we realize that it is not a one man job) to undertake to act as the cohesive force, to keep the chapter active by keeping them informed.
The 1960-61 Committee selected for judging the best chapter newsletter is:
Paul Eldering — Chattanooga Chapter
Irv Muesing — Indianapolis Chapter
Larry Haverkamp — Cincinnati Chapter

The budget established for awards for the chapter year 1960-61 amounts to $125.00.

The Committee, of course, can only judge what it receives, so we urge all concerned and particularly the Chapter Presidents and the Regional Directors, to make sure that their chapters forward to the Award Committee Chairman both brochures and newsletters. Send two copies of each newsletter and two copies of your chapter brochures to: Larry Haverkamp, Trailmobile Inc., 31st and Robertson Streets, Cincinnati 9, Ohio.

We hope that all Chapters and members will make a sincere effort to capture a national award, and we are looking for a very spirited campaign for this national recognition.

L. P. Haverkamp
Chairman, Awards Committee

*The San Francisco Chapter Brochure was judged the most effective in 1959-60. Emil Lage is shown receiving congratulations from President Millar.*

*President Millar presents Harry P. Kelley the award for the best article appearing in BUSINESS BUDGETING.*

*Bert Broder, representing the New York Chapter, accepts the award for the most effective series of Newsletters.*

# PROFESSOR WEINWURM REPLIES TO MR. DUDICK

**The June, 1960 issue of BUSINESS BUDGETING contained an article by Thomas S. Dudick entitled "Are We On The Threshold Of Another Depression?" The Editor, realizing that the subject was controversial, invited the readers to submit comments on the article. To date only one reader has submitted his views. Professor Weinwurm's comments are, no doubt, as controversial as Mr. Dudick's. Therefore, we again urge our readers to present their views on this important subject.**

Mr. Thomas S. Dudick's article in the June 1960 issue of Business Budgeting will certainly arouse a great deal of interest among budget men whose job is to appraise future developments. Much space would be required for a full discussion of his presentation; however, it appears that his position can be traced back to two fundamental assumptions.

The first assumption is that the past will repeat itself in the future more or less unchanged. The second assumption is concerned with the economic theory( or model) which explains actual developments, particularly the business cycle. These assumptions will be analyzed in these brief comments.

It is generally accepted that assumptions which must be made to explain all kinds of events in both nature and in the social world must be tested against actual facts. If it turns out that they fail to reflect those facts properly, they must be discarded.

The assumption that the past will repeat itself in the future is one of the basic tools of every "projection" into the future. Without this assumption any attempt of "predictions" would be futile. However, the same assumption can became extremely dangerous if events are occurring which indicate a different trend. In fact, *the past does not always and necessarily repeat itself.* The famous case of Mr. Sewell Avery of Montgomery Ward is a shining illustration.

Now it appears that the period of the last thirty years has been one of the greatest changes in history; perhaps, never have so many changes occurred in such a short time. In the circumstances, it will be essential to make a most careful evaluation of those changes before using developments of a generation ago as a guide for those to be expected in the future. Unfortunately, Mr. Dudick has done nothing of this kind; he has completely disregarded even the possibility that there have been fundamental changes. Perhaps, he is not even aware of them.

The second assumption relates to the economic theory used to explain factual developments. This assumption is much more difficult to analyze for, contrary to the first, it is bound to arouse strong emotions which may easily nullify the effects of logical reasoning.

The economic theory which, consciously or unconsciously, underlies business thinking in general, is based on assumptions and conditions of the past; it is very doubtful to what extent, if any, they are still relevant for an explanation of present-day conditions.

That theory which dominated the ideas and policies during the depression of thirty years ago was based on the assumption that business cycle fluctuations were a sort of "natural" and, consequently, unavoidable events which had to take their course while it was neither advisable nor possible to interfere with them; every interference would make things worse rather than better.

This theory of non-interference is now completely obsolete and discarded at least in fact although it still looms strong in the thinking of many business men.

The truth is that business cycles are "man made" and can be manipulated by a variety of techniques. The argument going on at this time is primarily about the proper techniques applicable under actual conditions and the proper time to use them.

Of course, this does not mean that there will be no more business fluctuations; however, it does mean that business fluctuations, both upwards and downwards, can be and will be subjected to active interference by both government and business.

Actual events during the last decade both in this country and all over the world provide ample

illustrations for this change in theory as well as in actual policies. Indeed, there have been no depressions since the end of the war and it can be assumed that appropriate measures will be taken to prevent one from developing if a trend in that direction should materialize.

It is not possible to discuss here the different techniques which may be used, their advantages and disadvantages and their proper timing. But it should be noted that long-range planning, a technique close to the heart of modern budget practitioners, provides one of the most powerful tools in this context by calling attention to more extended periods rather than concentrate on short-term events which are much more subject to substantial fluctuations.

Neither is it feasible to evaluate the social and political trends which have worked toward economic stability, for example, the full employment act which is on our statute books.

In conclusion, it is very important to remind the forecaster that he should never overlook the possibility of unfavorable trends; this is particularly so as the ranks of those who were witnesses of the big depression are now constantly shrinking. But, on the other side, it would be equally wrong to disregard all the changes which have happened during the last generation and continue relying on those old and now obsolete assumptions which must unavoidably lead to the wrong conclusions. More than most other people, budget men must keep an open mind for new events if they expect to promote their field and serve management satisfactorily.

*E. H. Weinwurm*
*De Paul University*
*Chicago, Illinois*

## BUDGETING PERSONNEL JOB DESCRIPTIONS

A recent letter from a non-member reader contained a request for sample job descriptions for budgeting jobs. A search through past issues of BUSINESS BUDGETING and other files failed to turn up any very worthwhile information. This appears to be a subject that should be of considerable interest to budget executives. NSBB members should have greater access to this kind of information than any other professional group. Will you please review your company's job descriptions for budget department personnel and send to the Editor two copies of those that you consider to be good examples. Titles that should be included range from budget director, budget manager, budget supervisor, budget analyst, budget estimator and budget clerk. If sufficient information is received the material will be used to prepare an article for a future issue of BUSINESS BUDGETING. Please be assured that your company will not be identified by name without your express permission.

Please mail your replies to:

THE EDITOR
BUSINESS BUDGETING
P.O. BOX 344
MOLINE, ILLINOIS

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MELVIN C. AICHHOLZ
(Signature of editor, publisher, business manager, or owner)
*Administrative Secretary*

Sworn to and subscribed before me this 1st day of October, 1960.

SEAL G. S. GATCH

# Increasing The Effectiveness of Budgeting By Use of Direct Costing Techniques

*By W. R. Hindman*
*Manager of Management Services*
*Lybrand, Ross Bros. & Montgomery*

**Direct costing as an accounting technique is a subject that has received a great deal of attention recently. Here is an article specifically relating direct costing and budgeting and, as such, should be of special interest to our readers.**

We are constantly seeking new techniques to maximize the effectiveness of budgets. The techniques I would like to explore in the following paragraphs is the technique of Direct Costing. Direct Costing is a "natural" for improving the effectiveness of budget planning and control.

## INDIRECT COSTS — TO ALLOCATE OR NOT TO ALLOCATE

What do you do with indirect costs in your company? Do you allocate them? Cost accounting, throughout its history, has always struggled with this problem of correctly allocating the so-called overhead expenses to different lines of products, to the many marketing areas, to the several production centers, and to the various branch offices. Then budgeting, after the allocation is made has struggled with the problem of how to control the allocated items. Even at present the enigma of "how to do it" is disturbing to the more thoughtful cost accountants and budgetary planners. Direct costing has inherited the riddle and in no small measure has contributed much toward its solution. There are many different methods of allocation in practice that gives varying degrees of solutions.

The No. 1 method, however, and one readily understood, is to do nothing. Under this plan of procedure the indirect costs are written off monthly to profit and loss, and without any allocations to products. This method of handling the indirects is not so "crass" as it sounds. The matter at least merits discussion. The real basic power of any product or any sales territory is portrayed by the indirects and profit ratio. It is the factor that measures the profit sway of a given line of product or a given branch or a specific sales territory. It is the high point of each product of each market territory, and this is the place where sales management must watch, must control, and must guide for achieving successful operations.

It is far more significant to see a product producing a 35 per cent ratio coupled with a satisfactory volume than to try by this or that manipulation to give the product its share of the indirect costs.

Doubt may arise that, by following the above suggested method, the full cost of the product is unknown and thus comparative costs with other lines and costs for product pricing are not possible. However, sales management, once the indirects and profit method is mastered, can readily figure the effect of any price change in a product or that of a competitor and, by so doing, register the result upon profits. The same figuring is at hand in measuring changing cost influences. Rather than determining costs for product pricing continuously, they are determined periodically — usually once each six months or once each year. Only at this time are all overhead costs applied to products on what is considered to be the most equitable basis which is practicable.

Closely related to the problem of allocating indirect costs are procedures for controlling them. There are real and outstanding savings immediately possible the very moment indirects are put under workable budgetary control. In order to accomplish this, however, management must be determined to obtain results. Control budgets over indirects under a direct costing plan should be on a monthly basis and should be planned in advance. In setting the budget for indirects a separate budget amount should be set for each indirect account.

## USE OF DIRECT COST DATA FOR COST CONTROL

A number of companies have found the standard direct cost system useful in the control and reduction of period or so-called "fixed" costs. Once they are segregated by responsibility groups, control over these costs becomes much easier to initate. The income statement sets forth all of these fixed and semi-variable costs as one large period charge. The so-called "fixed" costs were not so apparent under absorption costing. Management action taken as a result of the pinpointing and reporting of so-called "fixed" costs by responsibility groups has, in many instances, resulted in substantial cost reductions and the effective use of operating budgets for each department based on anticipated production. The net results of these programs, of course, show up monthly in the summary statement of income.

The segregation of all fixed and semi-variable costs, as one large period charge on the income statement, often proves far more useful for a comprehensive cost control and reduction program than a comparison of total costs on the absorption basis to job cost estimates or to absorption cost standards. Responsibility for period costs at various levels of standard labor hours is something which is easily understood at the foreman level.

## DEPARTMENTAL BUDGET REFORMS

How is direct costing helpful in controlling costs and thereby useful for profit planning at the departmental level?

The segregation of fixed and variable expenses by major activity or function provides a logical and realistic basis for budget planning and ultimately the control of costs by responsibility. The old "hoodoo" of allocating or apportioning fixed costs to variable production departments is eliminated, along with the crutch "I'm charged with that but I can't do a thing about it" which is so frequently used by supervisors when asked to explain variances incurred on costs over which they have no direct control. And unfortunately, all too often they spend this time worrying about indirect allocations, rather than attempting to control the direct items which they *can* do something about. In a positive vein, a greater incentive and sense of participation in cost control is provided to shop supervisors when they are charged only with costs over which they can exercise control.

One company with which I am familiar has approached this problem by developing two types of departmental budget reports — one for variable production departments and one for period cost departments.

The variable production department report is furnished to each foreman or shop supervisor. It presents a comparison of actual expenses to amounts allowed under the budget. Only those items over which control can be exercised are included.

The report presented to period cost departments reflects a comparison of actual results with step budget allowances. In this company step budgets graduated to varying production volumes and indexes have been established, and as significant changes in production volume occur, applicable period budget allowances are available for insertion on the reports for comparison with actuals. These period step budget allowances are recalculated once yearly, unless a major change which would affect the period costs takes place. Each department period cost report is presented to the appropriate department head, and all department period cost reports, as well as variable production department reports, are presented to the plant manager.

Direct costing allows the formulation of more realistic expense budgets for control over both fixed and variable costs. It allows the pinpointing of responsibility for costs to a far greater degree than absorption costing.

## EFFECTIVE COMMUNICATIONS

Budgeting is in reality a philosophy. A philosophy which requires effective communication. This does not mean that a company must have a radio system or teletype machine in every office. What does it mean? It means that a two-way exchange of opinions, ideas and suggestions must take place between top management, middle management, the salesman in the field, and the production man. The only way that a budgeting program can be successful, and this is just as true in a company which is using direct costing, is for all persons at all levels to understand the value of planning ahead and to have some knowledge (after they have reported their plans) of whether the plans are effective.

Once a budget figure is prepared, it can be refined after it is in operation. There is no guarantee that the first plan or budget developed is the best one. It would be impossible for any person to develop a plan that would not require changes from time to time. The important

thing in making estimates and forecasts is that all people in the chain of communications realize that the figures are "educated" estimates and that the factors which contributed to the estimate may change.

Budgeting is a real philosophy of planning and is not merely a bookkeeping system or a procedure where the "top" tells the "bottom" what to do. The success of the budget depends upon every person in the organization.

However, I think we can all agree that the real secret of effective budgeting is effective communications. Without effective communications between the budget personnel and sales and production personnel the budget plan will likely fail. Direct costing is a technique for improving communications with sales and production personnel, as statements on a direct costing basis are more easily understood by persons who do not have a financial or accounting background.

## ADVANTAGES OF DIRECT COSTING IN BUDGETARY PROFIT PLANNING

Let's summarize the advantages which direct costing has in budgetary profit planning:

1. The amount of fixed cost which must be covered before the company begins making a profit is readily apparent under a direct approach. This clearly points out the effect which management's long range policy decisions have in establishing fixed costs. Such information leads to better planning, through approaches to bring fixed costs into line with the amount of marginal income available.

2. Direct costing brings out the costs which can be changed by current operating decisions and permits ready evaluation in terms of profit for any proposal which will affect sales volume. In so doing, it is not necessary to consider changes in overhead absorption. A budgeted income statement for any product classification or for the company as a whole, based on a given sales forecast, can be prepared in a matter of minutes. This makes it possible to evaluate the effect of many different proposals, which may be made in the course of a budget conference, without interrupting the session.

3. Allocations may effectively be eliminated under a direct costing approach, and step budgets utilized to control indirect costs.

4. Direct costing is a better communications media to persons outside the financial and accounting area of a company.

## CONCLUSION

Direct costing is a fast growing management accounting technique. It is a technique which will fortunately assist us in improving controls within a company and in realizing recognizable results from budgeting plans.

## CORRECTION

The article titled "INVENTORY CONTROL FOR MANAGEMENT" by Mr. W. J. Williams published in the June, 1960 issue of BUSINESS BUDGETING contained an error which was called to our attention by the author. The first formula on page seven is stated as

$$Q = ST_L$$

The formula should read:

$$Q = ST_R$$ in order to agree with the statement following.

Our apology to Mr. Williams.

The Editor

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ROBERT W. RAPP — *Director of Accounting and Administration*
Akron Spool & Manufacturing Co., High Point, N.C.

# SECOND ANNUAL MIDWEST CONFERENCE

The Second Annual Midwest Conference was held at the Plankington House in Milwaukee on October 14. Omar Junker, General Chairman and his committee provided a perfect atmosphere for a successful Conference. Omar and the whole Milwaukee chapter were wonderful hosts.

The following is a list of the participating Chapters and the Chapter Representative:

| | |
|---|---|
| Calumet | John E. Zultner |
| Chicago | Lewis B. Landreth |
| Decatur | William E. Thomas |
| Detroit | Kenneth P. Locke |
| Fox River Valley | R. A. Swenson |
| Joliet-Kankakee | E. P. Garnier |
| Kalamazoo | William G. Clark |
| Milwaukee | Omar E. Junker |
| Peoria | R. B. Muzzy |
| Skokie | Lyle E. Dellefeld |
| Tri-Cities | Henry C. Doofe |
| Twin Cities | F. Jud Snell |

The total attendance was ninety-two, exactly the same as the number that attended the First Midwest Conference in Chicago a year ago. This attendance is all the more surprising in view of the fact that registration is limited to members of NSBB.

All seminars were enthusiastically received and the discussions were lively. The following is a summary of the seminars and the leaders:

**DECATUR CHAPTER**

*"Coordination of Financial Forecasting, Profit Planning and Control Budgeting"*

William E. Thomas, Professor of Accounting, University of Illinois

Arthur H. Brereton, Manager of Accounting, Marvel-Schebler Products Div., Borg-Warner

**CHICAGO CHAPTER**

*"Effective Presentation of the Profit Plan for Evaluation and Approval"*

Duane R. Borst, Assistant Controller, Profit Planning and Control, J. T. Ryerson & Company, Inc.

Lewis B. Landreth, Manager of Programing and Operational Analysis, International Minerals and Chemical Corporation

Carl O. Wessman, Budget Manager, Armour and Company

**TRI-CITIES CHAPTER**

*"Budget Follow-up"*

Henry C. Doofe, Assistant Secretary and Budget Officer of the Machinery Plant of American Machine and Metals, Inc.

**JOLIET-KANKAKEE CHAPTER**

*"Budgeting Maintenance Costs"*

Bernard J. Strozewski, Supervisor Costs and Budgets, General Foods Corporation

Thomas G. Wright, Assistant Chief Accountant, Joliet Works, American Steel and Wire Div. of U.S. Steel Corporation

Adrien M. Richard, Budget Director, Geo. D. Roper Corporation

A. H. Bulkley, Chief, Budget Branch, Ordnance Ammunition Command

*Conference Chairman Omar Junker, center, with committeemen Ken Bennett and Cy Prudhomme.*

**TWIN-CITIES CHAPTER**

*"Upgrading the Non-Financial Managers Input Into a Budget Program"*

F. Judson Snell, Chairman, New Products Committee, Temperature Controls Group, Minneapolis Honeywell Regulator Company

James H. Grenell, Controller, Temperature Controls Group, Minneapolis Honeywell Regulator Company

**DETROIT CHAPTER**

*"Profit Improvement or Planning"*

Eugene L. Sherk, Accounting Manager, Wyandote Chemicals Corporation

Eugene T. May, Expense Budget Controller, J. L. Hudson Company

**CALUMET CHAPTER**

*"Effective Reporting"*

William G. Clark, Budget Supervisor, KVP Sutherland Paper Co.

**FOX RIVER VALLEY CHAPTER**

*"Flexible Budgeting"*

George R. Morton, Budget Director, Automatic Electric Company

Robert A. Swenson, Assistant Budget Director, Automatic Electric Company

Gerald Avant, Budget Director, Elgin Watch Co.

Following the final seminar the scene of the Conference moved from the Plankington House to the hospitality room of one of Milwaukee's famous breweries and there the attendees enjoyed a genuine Milwaukee German "Gemutlichkeit." A tradition, started in Chicago one year ago, was admirably carried on by Milwaukee this year and several chapters have already submitted bids to host the Third Annual Midwest Conference next year.

## 1960 MIDWEST REGIONAL CONFERENCE SCENES

# NEW CHAPTERS . . . . . .

## BALTIMORE

Charter presented: September 19, 1960

Chapter officers:

| | |
|---|---|
| President | — Robert E. Thomas |
| Vice President | — David L. Wilson |
| Secretary | — Miss Alma M. Mules |
| Treasurer | — Eric Beissinger |

Charter members:

E. A. Baumbach, Theo. Hamm Brewing Co.
Eric Beissinger, Recipe Foods, Inc.
J. W. Bell, The National Brewing Co.
W. G. Brewer, Delvale Dairies, Inc.
E. E. Byrne, Eastern Stainless Steel
R. S. Fisher, Green Spring Dairy, Inc.
R. J. Guerin, Young & Selden Co.
B. E. Hynson, Aircraft Armaments, Inc.
M. J. Kelly, Delco Corp.
W. J. Kimmel, Catalyst Research Corp.
F. C. Lang, Waverly Press, Inc.
R. G. Lochiel, Capital Airlines, Inc.
G. W. McBride, Rosenthal's, Inc.
A. M. Mules, Baltimore Business Forms
M. N. Mullinix, The Martin Co.
M. B. Older, Baltimore Aircoil Co., Inc.
P. B. Schneider, Hoppers' Marylander Dining Room
S. Schwartz, Miller Metal Products, Inc.
J. W. Seifert, Wm. Schluderberg — T. J. Kurdle Co.
N. H. Shapiro, General Automatic Products Corp.
F. W. Sturgeon, The City Baking Co.
W. J. Suelau, Hedwin Corp.

*Bob Thomas, President of the Baltimore Chapter receives the Charter from Art Moor.*

R. E. Thomas, Arcrods Co.
G. C. Warehime, Baltimore Brick Co.
W. W. Whittle, Aeronca Mfg. Corp.
D. L. Wilson, McCormich & Co., Inc.
N. J. Boyle, Government Employees Insurance Companies

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## RICHMOND

Charter presented: October 24, 1960

Chapter officers:

| | |
|---|---|
| President | — Lawrence D. Whiting, Jr. |
| Vice President | — Clarence B. Drinkard, Jr. |
| Secretary | — F. Robert Farley |
| Treasurer | — C. W. Richardson |

Charter members:

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J. Bandrofcheck, Robertshaw-Fulton Controls Co.
W. C. Coward, The Chesapeake Corp. of Va.
C. B. Drinkard, Dalton & Drinkard
F. R. Farley, Albemarle Paper Mfg. Co.
H. M. Goldston, Life Insurance Co. of Va.
R. A. Gravatt, State-Planters Bk. of Commerce and Trusts
L. N. McLenagan, American Machine & Foundry Co.
M. B. Newcomer, Virginia-Caroline Chemical Corp.
S. T. Nystrom, David M. Lea & Co., Inc.
H. L. Price, Reynolds Metals Co.
K. A. Rainey, Union Bag-Camp Paper Corp.
E. A. Randlette, The Chesapeake & Ohio Rwy. Co.
C. W. Richardson, Reynolds Metals Co.
H. N. Robinson
E. A. Smith, Union Machinery Div. AMF
E. L. Tilley, Ernst & Ernst
L. D. Whiting, Jr., Reynolds Metals Co.

## NASHVILLE

| | | |
|---|---|---|
| Charter presented: | October 10, 1960 | |
| Chapter officers: | President | — William K. Clay |
| | First Vice President | — Henry W. Hornik |
| | Second Vice President | — Thomas J. Williams |
| | Secretary-Treasurer | — Wesley E. Hase |

Charter members:

William K. Clay, Tennessee Products & Chemical Corp.
Joseph G. Hart, American Pencil Co.
Wesley E. Hase, Avco Corp.
James A. Hlad, Ferro Corp.
Henry W. Hornik, Venus Pen & Pencil Corp.
David P. Turner, The Sunday School Board of the Southern Baptist Convention
Thomas Jay Williams, Aladdin Industries, Inc.

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## UTAH

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| Charter presented: | September 8, 1960 | |
| Chapter officers: | President | — William G. Nevers |
| | Vice President | — G. Melvin Glade |
| | Secretary-Treasurer | — Harold C. Davis |
| | Council Members | — Norman K. Jordan<br>Elmer R. Young |

Charter members:

Harold W. Belliston, Produce Livestock Marketing Association
William Layne Bracy, 1419 Harvard Avenue, Salt Lake City 5, Utah (Bracey Enterprises)
G. Wayne Clark, Auerbach Co.
Harold C. Davis, Mountain Fuel Supply Co.
Max . Edwards, Otto Buehner & Co.
Earl J. Evans, 4814 Harper Street, Salt Lake City 17, Utah (Spring Canyon Coal Co.)
George Melvin Glade, Western Steel Co.
Harold B. Hansen (Archer Tractor & Machinery Co.)
C. E. Johnson, Business Engineers Div., Business Controls, Inc.
N. K. Jordan, Interstate Motor Lines, Inc.
Victor Laughlin, Western Phosphates, Inc.
W. G. McFarland, Ernst & Ernst
W. G. Nevers, Thiokol Chemical Corp.
Sidney Noble (Tooele City Corp.)
L. P. Ott (Montek, Inc.)
H. D. Roth, Kennecott Copper Corp.
E. R. Young (University of Utah)
K. W. Cotton

*Art Moor presents the Charter to the Utah Chapter.*

# ABOUT MEMBERS

It isn't unusual for local chapters to devote one of their monthly meetings to a "current outlook" type of program. However, the Los Angeles Chapter added an unusual twist to their September meeting by asking Mrs. D. M. Hostetler, Manager of Hill, Richard and Company's Research Department to talk on "Current Business Trends in Southern California." Mrs. Hostetler's talk proved to be a very complete analysis of the outlook for the coming decade for the Los Angeles area and was well received by the members.

The Milwaukee Chapter is again sponsoring a course at Marquette University. It is called "Management Planning and Control Through Budgeting" and the "Professors" are members of the Milwaukee Chapter.

The Chicago Chapter also participates in an educational program. Chapter members have for several years been appearing as guest lecturers at a budgeting class given by DePaul University and are doing so again this year. Daytime as well as evening classes are manned by NSBB members. Also, two of the Chicago Chapter members are serving as instructors at the Illinois Institute of Technology. In addition to his other duties, BOB ECKLUND is teaching a course in accounting and MARIN GOLLOB is an Assistant Professor at the Institute.

DICK SHAW, immediate past president of the Cincinnati Chapter, was recently promoted by his employer, Procter & Gamble Company.

Several members of the San Diego Chapter have recently experienced job changes . . . ROSS STEVENS from Solar Aviation to Electro Instruments as Assistant Treasurer . . . FRANK WHIFFEN from San Diego Imperial to Standard Iron Works as Controller . . . HARRY MYERS from Rohr to Convair-Astro as Budget Analyst . . . BILL THORPE from Solar Aviation to Copley Press, Inc. as Procedures Coordinator . . . RALPH KULK of Marston's from Controller to Merchandising Manager . . . GROVER SNYDER of Ryan promoted to Chief of Budgets in the San Diego Division.

The Northern New Jersey Chapter has added an interesting new feature to their monthly meeting. The last 15 minutes of each meeting is being devoted to a Budget Clinic. Members are invited to present problems relating to their jobs and a panel of members then give their solution to the problem. Sounds like a good way to generate discussion.

J. G. NAGRO, New York Chapter member, presented a paper entitled "Realistic Budget Control for Large Scale Contracts" at the October meeting of the Technical Association of the Pulp and Paper Industry. The meeting was held in Jacksonville, Florida.

ROBERT E. SEXTON, President of the Indianapolis Chapter recently spoke at an American Management Association seminar on "Profit Planning with Budgetary Control."

VERN RUTTER, President of the Chicago Chapter, has been promoted from Assistant Comptroller to the Assistant to the Treasurer at International Minerals & Chemicals Corporation.

KENNETH P. LOCKE, Secretary of the Detroit Chapter was recently promoted to Assistant Controller of his company, The Detroit Edison Company.

On September 16, GEORGE W. JACKSON, past president of the Philadelphia Chapter and presently a Region I Director, spoke on "Capital Budgeting" to the Lancaster Chapter of the National Association of Accountants.

# "EXPANDING HORIZONS FOR BUSINESS PLANNING"

W. M. CAMPBELL
Conference Chairman

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